**LONDON BOROUGH OF TOWER HAMLETS**

**MINUTES OF THE PENSIONS COMMITTEE**

**HELD AT 6:00 P.M. ON MONDAY, 24 AUGUST 2020**

**ONLINE 'VIRTUAL' MEETING - HTTPS://TOWERHAMLETS.PUBLIC-I.TV/CORE/PORTAL/HOME**

**Members Present:**

Councillor Kyrsten Perry (Chair)
Councillor Rachel Blake (Vice-Chair)
Councillor Mohammed Ahbab Hossain
Councillor Eve McQuillan
Councillor Abdal Ullah
Councillor Andrew Wood

**Union and Admitted Bodies, Non-Voting Members Present:**

Kehinde Akintunde – GMB Union Representative
Colin Robertson – Independent Advisor
Steve Turner – Mercer
Hemal Popat – Mercer

**Apologies:**

Councillor Ayas Miah

**Others Present:**

Douglas Green – Hymans Robertson - Fund Actuary

**Officers Present:**

Miriam Adams – Interim Pensions and Investment Manager
Kevin Bartle – Interim Divisional Director of Finance, Procurement and Audit
Neville Murton – (Corporate Director, Resources)
Farhana Zia – (Democratic Services Officer, Committees, Governance)



**APOLOGIES FOR ABSENCE**

Apologies for absence were received from Councillor Ayas Miah and Ms Ngozi Adedji, Principal Lawyer Civil Litigation.

## 1. DECLARATIONS OF INTERESTS

There were no declarations of pecuniary interests made by members at the meeting.

## 2. REPORTS FOR CONSIDERATION

### 2.1 EXCLUSION OF THE PRESS AND PUBLIC

The Chair **Moved** and it was:

**RESOLVED:**

That in accordance with the provisions of Section 100A of the Local Government Act 1972, as amended by the Local Government (Access to Information) Act 1985, the press and public be excluded from the remainder of the meeting for the consideration of the Section Two business on the grounds that it contained information defined as exempt or confidential in Part 1 of Schedule 12A to the Local Government, Act 1972.

### 2.2 Equity Protection Strategy

The Chair Councillor Kyrsten Perry explained an extraordinary meeting of the Pensions Committee had been called following the deferral of decision regarding the Equity Protection Strategy at the meeting of 27th July 2020. She informed Members the decision regarding Equity Protection was required before the end of August and as such it was imperative the whole membership was present for this item.

The Chair invited Mr Steve Turner from Mercer to introduce the report and give an update.

Mr Turner said the Committee had previously approved an Equity Protection strategy in 2018, which effectively gave the Pension Fund a healthy return of £48M. Mr Turner said there had been a huge rebound in the equity market since March 2020, following a fall due to COVID19, and there was a lot of uncertainty in the markets about the outlook for global economies. He said that if equity markets fell by 20% to 30% over the next 12 to 24 months, this would not be a surprise given the environment.

He said 50% of the Pension Fund investment was allocated to the equity markets and other assets held, such as multi asset credits and diversified growth, were highly correlated with the equity market, and so would also see a fall. He said it was hard to predict the falls, but the Equity Protection policy would give a buffer against the falling markets.

Mr Colin Robertson, the Independent Advisor was asked to give his outlook on the equity markets. Mr Robertson said his views hadn't changed in that there was a disconnect between the level of equity markets, which is driven by a narrow group of stocks such as Apple, Amazon etc, and the economic and medical fundamentals. Mr Robertson said the gap had increased since this was last discussed at the end of July, and the economic outlook was no better than expected. As a point of clarification, Mr Robertson said if the markets fell, the Fund should in practice not need to wait until the expiry of the contact to in effect close the position. Mr Hemal Popat from Mercer added the Equity Protection policy could in effect be closed at any time with the Fund getting back the value at the date of closure.

In response to question from Members the following was noted.

- Mr Popat was asked to explain what the implications were for cashing in early and if this was a good idea. He responded saying the policy gave the Fund the option of terminating the contract depending on what happened in markets. He said the Fund did not have to exercise this option and as such the Committee should be comforted by the fact the option was available. He said broadly speaking there were two scenarios where the policy might be cashed in, (1) if the markets had a dramatic fall, to extract the value of the policy or (2) if the policy was coming close to expiry and the Fund wanted to enter into a new equity protection policy. Mr Robertson said the Fund did not have to exercise this option, but the option was there. He said due to the unpredictability of the market, the equity protection might be considered an insurance policy against the risk of a big fall in equity markets. He said if the equity markets did fall by 30%, then as around 50% of the Pension Fund was invested in equities, the fund would be at considerable risk.
- Members asked why Equity Protection was needed and asked to be reminded why it was taken out in 2018. Mr Turner explained that in 2018 an Equity Protection policy was taken out because there were concerns about the outlook of the equity markets and secondly because the actuarial valuation was due as at 31 March 2019 and therefore it was thought it would be useful to avoid a large drop in the value of the fund around the time of the valuation. Mr Turner said the reasons for taking an Equity Protection policy this time was purely on an investment case, to protect the investments at a time when there was so much uncertainty in the global economy. He said the Fund was in a stronger position than in 2018 and therefore the Committee would be taking out Equity Protection from a position of strength. Mr Turner also added that the previous Equity Protection policy was closed out following the Pensions Committee meetings of February/March 2020, with a proviso that the Committee would look at Equity Protection closer to the US Elections. However, the global pandemic had resulted in this being discussed in the July and August meetings of the committee.

Mr Douglas Green from Hymans Robertson LLP was asked for his views on whether the Committee should consider taking out an Equity Protection policy.

Mr Green said counter-intuitively taking out an Equity Protection policy would have no material effect on the long-term contributions requirements of Employers. He said that from a funding perspective, there was no right or wrong answer to if an Equity Protection policy should be taken out or if this would result in contributions going up. He said it was a case of giving something up as well as gaining something. He advised Members not to get hung up on the council contributions and the value of assets.

With regard to the early calling off of the policy, he said holding the policy until expiry was like insurance. However, if the policy was sold or cashed in at an earlier date, then the value of the policy was variable depending on the state of the markets as well as how early the policy is cashed in. He said in principle it was not providing protection if the policy was sold because it could be argued that the person to whom the policy was sold would be expecting further market falls. Nevertheless, Mr Green noted the proposed policy had a spread of expiry dates which minimised the risk.

Lastly, Mr Green said the Committee should view the Equity Protection as a short-term policy. He said two years over the lifetime of the Fund was a short timeframe and he did not want the Committee to be regularly taking out equity protection as this would imply the Fund was uneasy about investing in the equity market. The Committee should be looking at its long-term strategy.

Mr Turner from Mercer concurred with Mr Green's view. However, the Fund needed to be able to react to market events and the pandemic was an unprecedented event.

Mr Robertson agreed that Equity Protection should not be taken out on a regular basis. He also agreed that that the cashing in of the policy early required a buyer to be found although Mercer had indicated that should not be a problem. He added that the policy is unlike a fixed term product such as some bank accounts whereby the early termination leads to penalties. This might incur a cost but not a penalty.

**Transactional Costs**
In reference to transaction costs, Mr Hemal Popat of Mercer referred Members to page 8 and 9 of the agenda and the two-page document appended. He said the figures were conservative indicators of what the costs would be should the policy be terminated early. However, in practice a best estimate figure would be half of this figure. For example, if option 2a was chosen, it would be the current value minus the cost of £1M.

Mr Kevin Bartle, Interim Divisional Director for Finance, Procurement and Audit said he was concerned about what 'cashing in' and 'selling off' meant should the equity protection policy be agreed. He said there was a difference between cashing in a policy and selling it, whereby you require a buyer to buy the policy. Mr Hemal Popat responded saying the detail would depend on the contract involved. He said the previous equity protection policy was a customised contract with the bank, and when this expired the bank was responsible for unwinding the contract, which lead to transactional costs. Similarly, the current proposal and the costs shown in the table relate to an

Equity Protection policy taken out with a bank. Mr Popat said alternatively the policy could be purchased using Exchange Traded contracts which would attract a much lower cost than those shown in the table. Mr Popat said the market for this was extremely liquid and it was very unlikely a buyer could not be found for the policy should it be sold.

Mr Colin Robertson added that the policy could be kept for the duration of two years rather than it being sold and still be of value for the fund.

In response to questions from Members the following was noted:

- When questioned about the best time to purchase an Equity Protection Policy, should the Committee decide on one of the three options presented, Mr Hemal Popat said the market was diversified and the majority of transactions were carried out by hedge funds, investment managers, exchange traded funds and banks as part of their on-going policy. Pension funds form only a small part of the overall market. So there is limited risk of pension fund demand moving prices. In Mercer's view conditions are currently reasonable to buy an Equity Protection Policy.
- In response to what other options were available other than taking out Equity Protection, Mr Robertson and Mr Turner said the Fund could for example reduce the equity it held from 50% to 40%, but this would be disruptive which would disadvantage the Fund. Mr Turner said if the selling of equities happened then the Committee would need to make decisions on what it would be reinvesting the monies in i.e. another asset class. There would be governance issues to resolve and timing decisions involved. It would not be more advantageous than taking out an Equity Protection policy. Mr Turner said that Mercer had proposed that contracts roll off in stages at 12, 18 and 24 months to spread expiry dates.
- Mr Neville Murton, Corporate Director for Resources said that as part of the long-term strategy the fund would not have such a large investment in equities when the funding level is close to 100%.
- In the context of why the priced options capped gains at 10% and losses did not start to be covered until they exceeded 10%, Mr Douglas Green asked if this was broadly symmetrical as investors thought equities were equally likely to rise or fall. Mr Robertson responded saying there is an assumption that the markets are perfectly priced however that may not be the view of individual investors. He said we thought the fundamentals were a lot worse than the market expected, so the risks were slanted downwards in our view.

The Chair, Councillor Kyrsten Perry asked members for their views in principle to the proposal put forward.

- Councillor Wood indicated that he did not think an Equity Protection policy was needed as the Fund was 100% funded. He said he was less bearish than other committee members and did not think it was worth spending £15m to protect against the risk of a 30% fall in equities. However, he was only 51%/49% in favour of this view. Councillor Wood said he had changed his mind regarding the options available. He said he was now in favour of Option 2a rather than 2, should the committee decide it wanted to take out Equity Protection.

The Pensions Committee unanimously **AGREED** to taking out an Equity Protection Policy in principle and noted Councillor Wood's reservations.

- Councillor Blake enquired why Councillor Wood had changed his view from Option 2 to Option 2a. Councillor Wood responded saying he was unsure of the equity market loosing value back in July but on reflection the probability of stocks falling was more likely and therefore Option 2a was a more logical and consistent position to take.
- Councillor Perry asked for confirmation that Option 2 would mean £300M would be protected and Option 2a would mean £600M would be protected, so Option 2 was being less cautious. Mr Popat confirmed this to be the case. He said in Option 2 one-third would be protected whereas Option 2a meant two-thirds would be protected.

Mr Hemal Popat gave a detailed explanation of the three options available saying the options offered different levels of protection with respect to the potential downside losses.

- Councillor Eve McQuillan asked what the best guess was in relation to what would happen to equity markets. Mr Robertson said this was hard to predict but if you thought the risk of a large upwards move in equities was significant (in comparison to a larger risk of a small upwards move in equities) then you would favour Option 2 over Option 2a. Mr Popat added that from his view the most likely movements in the market would be modest up or down movements rather than large movements in either direction.

Councillor Perry asked which Option was being recommended to the Committee. Mr Popat said Mercer were in favour of Option 2a. Councillor Perry enquired if some middle ground could be taken between Option 2 and 2a with a staggered timeline.

Following discussion including of the impact the USA Elections may have on the equity market, Mr Popat said it was for the Committee to decide how it wished to move forward. However, whilst some protection could be purchased now and some later, the pricing provided was attractive now. Mr Popat said it was an unknown what would happen to markets and options pricing post November.

Mr Neville Murton, Corporate Director for Resources was asked for his view. Mr Murton said his preference was for Option 2a. He also said last time some broad parameters were set for the Officers to be aware of when using their delegated powers at the time the Equity Protection was purchased.

The Pensions Committee **RESOLVED** to take a **VOTE** for Option 2a

and it was unanimously **AGREED** that this was the option that the Pensions Committee would be recommending.

Therefore, the Pensions Committee:

1. Noted the content of the report
2. Considered the recommendations of Mercer, the Fund's Investment Adviser (Appendix A);
3. Considered the recommendations of the Fund's Independent Adviser (Appendix B);
4. Noted the procurement considerations;
5. Noted the request for £20M operational cash in earlier agenda item, as discussed at the 27th July 2020 meeting;
6. Agreed the proposed action to put in place Equity Protection; and
7. Delegate implementation of the strategy to the Corporate Director of Resources.

## 3. ANY OTHER BUSINESS CONSIDERED TO BE URGENT

No other urgent business was discussed.



The meeting ended at 7:20 p.m.

Chair, Councillor Kyrsten Perry
Pensions Committee